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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

KEVIN ALFARO, as Trustee, etc., Petitioner and Respondent, v. RONALD PATTERSON, as Trustee, etc., et al., Objectors and Appellants.	A155661 A155822 (Napa County Super. Ct. No. 26-38094)

John Carpy and Ronald Patterson appeal the trial court's order apportioning the estate tax liability among the beneficiaries of an estate. We agree that the trial court erred in determining the apportionment, and reverse.

BACKGROUND

In 1989, Charles and Ann Carpy established a trust.[1] When Charles died, the trust terminated and its assets were distributed into four new subtrusts (the Carpy Subtrusts). Ann was the sole beneficiary of the Carpy Subtrusts and respondent Kevin Alfaro was named the trustee. Ann's children, including John, were beneficiaries of her estate. Upon Ann's death, John's share was to be retained in a lifetime trust for his sole benefit and his siblings were to receive their shares outright.

[1] To avoid confusion, we refer to Charles, Ann, and John Carpy by their first names. No disrespect is intended.

Various disputes arose between John and Ann and/or his siblings, some resulting in litigation. A settlement was reached between Ann, John, and John's three siblings (the Settlement Agreement) whereby each of the four Carpy Subtrusts would be split into two new subtrusts, one containing 25 percent of its assets and the other containing 75 percent. The four new subtrusts containing 25 percent of the Carpy Subtrusts' assets (the 25% Subtrusts) would be managed by a separate, professional trustee and, upon Ann's death, would be placed in a lifetime trust for John's benefit. The four new subtrusts containing 75 percent of the Carpy Subtrusts' assets (the 75% Subtrusts) would be managed by respondent and, upon Ann's death, would be distributed to John's three siblings. The intent was that the 25 percent share of Ann's estate that was to be John's inheritance would be separately managed during Ann's lifetime.

At issue here is the Settlement Agreement's division of certain illiquid assets held by the Carpy Subtrusts: a 50 percent ownership interest in a limited liability company and a 50 percent tenancy-in-common interest in two properties (collectively, the LLC/TIC Assets). As to these assets, the Settlement Agreement provides that the 75% Subtrusts receive the entire interest held by the Carpy Subtrusts, and the 25% Subtrusts receive an assignment of 25 percent of any distributions from these assets received by the 75% Subtrusts during John's lifetime.[2]

Ann died on December 27, 2016, a date the parties later stipulated was the Settlement Agreement approval date. The 75% and 25% Subtrusts were subsequently created and funded, and appellant Ronald Patterson was named trustee of the 25% Subtrusts. Respondent, trustee of the 75% Subtrusts as well as the Carpy Subtrusts, prepared the estate taxes for Ann's estate. Respondent took the position that the 25% Subtrusts should pay for 25 percent of the estate taxes and the 75% Subtrusts should pay for the remaining 75 percent, with the exception of taxes attributable to certain personal

[2] The parties apparently did not wish to divide these interests because, with respect to the limited liability company, the owner of the remaining 50 percent interest would not agree to allow John any ownership interest, and with respect to the tenancies-in-common, division of the interest would result in a property tax reassessment.

property which is not at issue here. Appellants took the position that the 25% Subtrusts' distribution rights from the LLC/TIC Assets was worth less than 25 percent of the total value of the LLC/TIC Assets, and therefore the 25% Subtrusts should pay less than 25 percent of the estate tax liability.

Respondent filed the instant petition seeking instructions as to the proper allocation of estate tax liability among the beneficiaries of Ann's estate. Appellants filed objections and the parties stipulated the trial court could decide without an evidentiary hearing. The trial court, after considering the Probate Code,[3] Settlement Agreement, and extrinsic evidence, concluded the 25% Subtrusts were responsible for 25 percent of the estate tax payment owed on Ann's estate. These appeals followed.[4]

DISCUSSION

I. *Legal Background*

"The Legislature has enacted specific rules for determining the source of payment for estate taxes, interest and penalties. (See § 20100 et seq.) These provisions seek to accomplish ' "the equitable allocation of the burden of the tax among those actually affected by that burden." ' [Citation.] This state has a ' "strong policy" ' favoring the statutory apportionment rules. [Citation.] [¶] The general rule, set forth in sections 20110 and 20111, is that the burden of estate taxes should be borne by each beneficiary to the extent the beneficiary's share of the property has contributed to the tax." (*Simpson v. White* (1997) 57 Cal.App.4th 814, 820 (*Simpson*); see also § 20111 ["The proration required by this article shall be made in the proportion that the value of the property received by each person interested in the estate bears to the total value of all property received by all persons interested in the estate, subject to the provisions of this article."].)

[3] All undesignated section references are to the Probate Code.

[4] Patterson (the 25% Subtrusts' trustee) and John filed separate appeals from the same order, which we previously consolidated. They filed substantively identical opening briefs, and John filed a letter joining in Patterson's reply brief. We grant John's May 16, 2019 unopposed motion to augment the record.

"Section 20113 creates an exception to this rule applicable where a decedent has created a temporary and remainder interest in the same property. [Citation.] Under section 20113, the estate taxes must be paid from the corpus of the property without allocation between temporary and remainder interests. The rationale underlying this code section is that '. . . the most *equitable* approach to proration is to direct the allocable tax to the asset itself and to permit the impact of the payment to adjust itself, as between the holders of the successive interests, over time.' " (*Simpson, supra,* 57 Cal.App.4th at p. 820, fn. omitted; see also § 20113 ["If a trust is created, or other provision made whereby a person is given an interest in the income of, an estate for years or for life in, or other temporary interest in, any property, the estate tax on both the temporary interest and on the remainder thereafter shall be charged against and paid out of the corpus of the property without apportionment between remainders and temporary estates."].) Where this provision applies, "if the asset is . . . illiquid, and if the parties and the probate court can find no alternative solution, the asset may have to be sold to effect the payment of allocable estate tax required by section 20113." (*Estate of Malpas* (1992) 7 Cal.App.4th 1901, 1909.)

The above statutory proration rules do not apply "[t]o the extent the decedent in a written inter vivos or testamentary instrument disposing of property specifically directs . . . that an estate tax be prorated to the property in the manner provided in the instrument." (§ 20110, subd. (b)(1).) "[B]ecause of the ' "strong policy in favor of statutory apportionment," ' a testator's intention is to control only when that intention is ' "clear and unambiguous." ' [Citation.] Ambiguities are to be resolved in favor of statutory apportionment." (*Simpson, supra,* 57 Cal.App.4th at p. 822.)

II. *Analysis*

A. *Standard of Review*

We review de novo the issue of whether the Settlement Agreement is ambiguous. (*Founding Members of the Newport Beach Country Club v. Newport Beach Country Club, Inc.* (2003) 109 Cal.App.4th 944, 955.) Our review is also de novo where any

extrinsic evidence is not in conflict; we review for substantial evidence the trial court's construction based on conflicting extrinsic evidence. (*Id.* at pp. 955–956.)

B. *Section 20111*

All parties agree that the proportionate proration rule of section 20111 applies. Appellants contend the language of the Settlement Agreement unambiguously so directs or, at the least, the language does not specifically direct otherwise. Respondent contends that the Settlement Agreement is ambiguous with respect to the apportionment of estate taxes, and that the ambiguity requires the application of the statutory rule.

The Settlement Agreement provides that "the Trustee of the 25% SUBTRUSTS shall pay . . . all death taxes due on account of the death of ANN that are attributable to assets that are part of the 25% SUBTRUSTS or that are added at the death of ANN to the estate (whether by probate administration or otherwise) from the 25% SUBTRUSTS . . . ." The same language applies to the 75% Subtrusts. We agree with the parties that this language—providing each set of subtrusts is liable for the payment of estate taxes "that are attributable to assets that are part of" those subtrusts—does not specifically direct a method of proration contrary to the proportionate allocation provided by section 20111.[5] We therefore need not decide whether it unambiguously so provides, as appellants contend.

[5] Respondent does not appear to argue that the Settlement Agreement, as construed by the trial court in light of extrinsic evidence, specifically directs another method of proration. The trial court found the language of the Settlement Agreement ambiguous and noted extrinsic evidence indicating the parties intended liability for estate taxes to be proportionate. The court noted the 25% Subtrusts' interest in the LLC/TIC Assets had "limited powers and duration," rendering it "to some degree less valuable than the other 75% interests." The court then found "this diminution in value is not readily quantifiable with any true degree of accuracy," and a construction of the Settlement Agreement requiring such a quantification would result in an interpretation that is not "definite, reasonable, or capable of being carried into effect (at least not readily so)," contrary to Civil Code section 1643. In part on this basis, the court construed the Settlement Agreement to provide the 25% Subtrusts pay 25 percent of the estate taxes attributable to the LLC/TIC Assets. We note that there is no evidence in the record that valuation of the parties' respective interests in the LLC/TIC Assets would be unduly difficult. In any

The parties dispute how to apply the proration rule of section 20111. Respondent appears to contend that the interest in the LLC/TIC Assets held by the 25% Subtrusts—an interest in 25 percent of the distributions made—is worth 25 percent of the entire value of the LLC/TIC Assets. Appellants contend that the 25% Subtrusts' interest is worth less than 25 percent because the distribution right does not confer any management control over the LLC/TIC Assets, the distribution right terminates upon John's death, and the LLC/TIC Assets have not historically made distributions. While the valuation of the 25% Subtrusts' interest in the LLC/TIC Assets is not before us, at least some of the factors raised by appellants may result in a decrease in the relative value of the interest, as compared to the interest held by the 75% Subtrusts.

Respondent argues that reducing the value of the 25% Subtrusts' interest in the LLC/TIC Assets because of these factors would result in an underpayment of federal estate taxes: "If any of the above factors (e.g., lack of controlling interest, lack of distributions) were relevant to the proration of estate taxes for the 25% [Subtrusts], then those same factors would *also* apply to discount the amount of estate taxes owed by the beneficiaries of the 75% [Subtrusts] (which also lack a controlling interest and have yet to receive distributions). That would, however, result in an underpayment of the estate taxes owed to the IRS. The estate tax return could not have been prepared with the additional discounts to which John thinks he is entitled (but Ann's estate is not entitled). The estate tax return must be accurately prepared based on the assets Ann owned at her date of death and the value of those assets on that date in *her* hands, not John's hands." Respondent's argument conflates the determination of the relative values of the interests held by the 25% Subtrusts and 75% Subtrusts with the valuation used to determine the estate tax. The purpose of the former is only to determine the value of the parties' interests with respect to each other. If, for example, the lack of distributions impacts both interests equally, that factor will not change their relative value regardless of any impact

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event, the trial court did not find, and no party argues, that this construction constitutes the requisite "specific[] direct[ion]" contrary to the proration rule of section 20111.

it has on the valuation for estate tax purposes. If, however, the 75% Subtrusts' minority control over the LLC/TIC Assets is more valuable than the 25% Subtrusts' lack of any control, the relative values may shift such that the 25% Subtrusts' interest is only worth 20 percent of the total value of the LLC/TIC Assets and the 75% Subtrusts' interest is worth 80 percent. This relative value, in turn, will determine each party's liability for the estate tax attributable to the LLC/TIC Assets (which itself is based on a valuation of the assets pursuant to relevant laws and regulations). (See *In re Buckhantz' Estate* (1953) 120 Cal.App.2d 92, 99 ["The task of proration begins at the point where the taxing authorities end their duty of fixing the estate tax; it takes the accomplished fact of taxation and then prorates the burden on the actuality of the tax."].)

Accordingly, under section 20111, the parties' respective liability for the estate tax attributable to the LLC/TIC Assets depends on the comparative value of their interests in the LLC/TIC Assets.

C. *Section 20113*

Appellants also contend that section 20113 applies and requires the LLC/TIC Assets be sold to pay for the estate tax liability attributable to those assets. We need not decide whether the 25% Subtrusts' interest in the LLC/TIC Assets is "temporary" for purposes of section 20113, as the parties dispute, because we conclude the Settlement Agreement specifically directs a contrary method of estate tax payment.

The Settlement Agreement, in the same provision requiring the trustee of the 25% Subtrusts to pay for estate taxes (as well as other payments), provides as follows: "The Trustee shall make such payments first from assets of the 25% MARITAL QTIP TRUST (and first from the portion that is nonexempt from GST tax) and then from assets of the 25% SURVIVOR'S TRUST (and first from the portion that is nonexempt from GST tax)." The Settlement Agreement similarly provides with respect to the 75% Subtrusts. The Settlement Agreement thus specifically directs that all estate taxes—including those attributable to temporary interests—are to be paid from particular assets of the trusts, rather than from the asset responsible for the estate tax. Accordingly, even if the 25% Subtrusts' interest in the LLC/TIC Assets is temporary for purposes of section 20113, the

Settlement Agreement specifically directs a contrary method of satisfying the estate tax liability attributable to those assets. This conclusion is not in conflict with our previous conclusion that the Settlement Agreement does not specifically direct a rule contrary to section 20111's proration rule, as a written instrument "controls only to the extent it directs a rule contrary to the statutory mandate." (*Simpson, supra,* 57 Cal.App.4th at p. 822.)

DISPOSITION

The order is reversed and remanded for proceedings not inconsistent with this opinion. Appellants are awarded their costs on appeal.

SIMONS, J.

We concur.

JONES, P.J.

NEEDHAM, J.

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